No. 2827

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of Creech Brothers Lumber Company, a Corporation, Bankrupt.

A. R. Titlow as Receiver of the United States National Bank of Centralia, appearing in the name and Stead of Robert G. Chambers, as Trustee in Bankruptcy of the Estate of Creech Brothers Lumber Company, a Corporation, Bankrupt,
Petitioner and Appellant,

vs.

H. W. MacPhail,
Respondent and Appellee.

UPON APPEAL AND REVIEW FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

BRIEF FOR RESPONDENT AND APPELLEE.

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vs.

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BRIEF FOR RESPONDENT AND APPELLEE.

STATEMENT OF THE CASE.

That on and prior to the 29th of October, 1912, Creech Brothers Lumber Company, which was a corporation duly organized and existing under and

by virtue of the Laws of the State of Washington, was engaged in operating a saw mill at Raymond, Washington. Creech Brothers Lumber Company had become insolvent and was unable to pay any part of its indebtedness and all of its creditors were pressing their claims. On October 29, 1912, the Creech Brothers Lumber Company entered into a contract in writing with H. W. MacPhail, a copy of which is found on pages 22 to 26 of the Transcript of Record. That at the time of the execution of said contract, each and all of the then creditors of the Creech Brothers Lumber Company entered into a written agreement authorizing the Creech Brothers Lumber Company to execute the contract with MacPhail. This written agreement is found on pages 27 to 29 of the Transcript of Record. All of the stockholders of the Creech Brothers Lumber Company also authorized it in writing to execute said contract with MacPhail. (See pages 26 and 27 of Transcript of Record). At the time of the execution of the contracts referred to, the United States National Bank of Centralia, Washington, was not a creditor of the Creech Brothers Lumber Company, and thereafter it was placed in the hands of a Receiver, and A. R. Titlow, the petitioner and appellant, is the Receiver of the United States National

Bank of Centralia. That at the time of the execution of the contract, which MacPhail had with the Creech Brothers Lumber Company, and at the time of the execution of the contracts by the then creditors of the Creech Brothers Lumber Company, the U. S. National Bank of Centralia was not a creditor of the said Lumber Company. But the Willapa Harbor State Bank was a creditor and it signed the agreement authorizing the Lumber Company to execute the contract with MacPhail, and thereafter the Willapa Harbor State Bank of Raymond, Washington, which held notes which had been executed by the Creech Brothers Lumber Company, sold said promissory notes to the United States National Bank of Centralia, and it was in this manner that the United States National Bank became a creditor of the Creech Brothers Lumber Company. These notes were sold to the United States National Bank subsequent to the execution of said contracts and while MacPhail was operating the Creech Brothers Lumber Company plant under said contracts. That at the time the United States National Bank purchased these notes from the Willapa Harbor State Bank, and thus became a creditor of Creech Brothers Lumber Company, it took with notice of all the facts and of the existence of the

contracts signed by the creditors and of the existence of the contract which the Creech Brothers Lumber Company had with MacPhail, for the reason that C. S. Gilchrist was the President of the Willapa Harbor State Bank and was the Vice President and Manager of the United States National Bank of Centralia, Washington, and the testimony shows that Gilchrist was instrumental in obtaining the signatures of some of the creditors to the contract which was executed between Creech Brothers Lumber Company and MacPhail, and he was instrumental in getting the creditors to sign and agree in writing that Creech Brothers Lumber Company might execute such a contract with McPhail. (See Transcript of Record, pages 43-44, and see also the Findings of Fact made by the Court on page 60). That after the execution of the contracts above referred to, Mr. MacPhail took charge of the plant and employed Mr. B. H. Lewis as manager. Mr. Lewis had had about thirteen years experience in the lumber business and had managed other lumber plants of greater capacity than the plant in question at that time and prior to that time he had been manager of the Quinault Lumber Company at Raymond, Washington, which mill had a cutting capacity of 100,000 feet per day. (See

Transcript of Record, pages 35 to 37). The plant was operated by Mr. MacPhail for a period of about seven and one-half months. During the early part of that period the plant was operated at a profit of $1000 or more per month, but later on, and somewhere about the first of June, 1913, there was a rapid decline in the lumber market, and within a period of thirty days thereafter the price of lumber declined from $8 to $10 per thousand. Before this decline occurred Mr. MacPhail had entered into contracts for the sale of certain lumber, but the contracts were such that the entire cut of the mill could not be applied on the contracts, that is, about thirty per cent. of the amount of lumber cut from each log could be made to apply on the particular contract, and consequently it was necessary for him to sell the remaining seventy per cent. in the open market, and when the decline occurred he found himself in this condition; he could continue cutting on the contract and while there was a profit in cutting this thirty per cent. that applied on the particular contract, there was considerable loss in handling the remaining seventy per cent. If he closed the mill and refused to fill the contracts, then of course he would be liable to an action for damages; and Mr. Lewis believed, and so testified,

that it was better to continue and complete the contracts, than be involved in litigation by reason of breaching the same. Mr. MacPhail, of course, followed the judgment and advice of Mr. Lewis, as he was a man skilled in the lumber business.

When Mr. MacPhail entered into the contract with the Creech Brothers Lumber Company there was a large sum of money due for delinquent taxes upon the property of the Lumber Company and a large sum due for fire insurance premiums written upon the plant and in order to maintain the insurance it was necessary to pay the premiums which were in arrears, and which Mr. MacPhail did pay, amounting to $3189.46, and he paid taxes amounting to $2165.01; and during the time he was operating the plant, he paid interest to the various creditors amounting to the sum of $8271.80, and paid a dividend of ten per cent. to each creditor, which dividend amounted to approximately $13,000. He also paid out a considerable amount of money for repair and maintenance of the plant which amount is carried on the itemized statement attached to his proof of claim under the head of "Supplies and Expense" and which amounted to the sum of $7028.02. (See pages 40-41, Transcript of Record).

We are calling the Court's attenton to these

matters for the reason that all of these sums were expended by MacPhail for the maintenance of the plant, and all inured to the benefit of the creditors, for the reason that the plant would have been left without insurance, would have been sold for taxes, and would have otherwise deteriorated had it not been for the fact that Mr. MacPhail loaned his credit and advanced his money for the protection of all the creditors under the contract with the corporation and with the creditors. Mr. MacPhail was acting entirely without compensation in an endeavor to save the Creech Brothers Lumber Company when it was financially embarrassed, and he entered into the contract with the Creech Brothers Lumber Company with the written consent of all of the creditors and all of the stockholders. See pages 27 to 32, Transcript of Record).

We desire to quote briefly from the two contracts, merely for the purpose of directing the Court's attention to what we consider the controlling clauses in the contracts. In Exhibit "A" (Pages 22 to 27, Transcript of Record) we find the following:

> "It being distinctly understood by and between the parties hereto that any sums ad-

vanced by the second party or any sums which he may contract as indebtedness in the operation of said plant, or in the purchase of logs or the employment of labor for the operation of said plant shall be a first and prior lien and shall be paid prior to the payment of any sums now due the creditors of said corporation.

"The second party agrees that he will, as agent for and in the name of said corporation, purchase logs and employ labor and operate said mill for and in the name of said corporation so long as the same can be operated at a net profit of One Thousand Dollars or more per month and that from the profits derived from the operation of said plant, he shall first reimburse himself for any sums advanced by him and shall next pay and discharge any bills or indebtedness which he may contract in the operation of said plant, and the remainder, if any, he shall pay to the creditors pro rata, share and share alike, in proportion to their said claims until all of said claims, together with interest thereon at the rate of eight per cent. per annum, have been fully paid, satisfied and discharged, and if there shall be any surplus, to pay the same to the first party, its successors and assigns.

"It being distinctly understood and agreed, however, that if said plant when operated in a good, diligent and business like manner should not clear the sum of One Thousand Dollars per month, net, that then the second party may at his option, cease to operate said plant, and sell and dispose of all of said real estate and personal property, and accounts and bills receivable for the purpose of first reimbursing himself

for any sums advanced by him or any sums contracted by him in the operation of said plant, and second to pay the creditors of the first party in full or pro rata, and the fact that he may cease to operate said plant shall not be construed as terminating his rights under this contract until he has been fully paid for all sums by him advanced and until all sums by him contracted for have been fully paid, satisfied and discharged, and creditors have been paid in full or said assets have been all reduced to cash and the second party reimbursed, and the balance paid pro rata to the creditors of the first party."

In exhibit "B" (Pages 27 to 29, Transcript of Record) which is the contract signed by the creditors, we find the following:

"It being understood that in the operation of said plant that the said H. W. MacPhail shall first pay the cost of operation and all sums contracted by him as such assignee, and all sums advanced by him, and thereafter shall pay to the creditors interest at the rate of eight per cent. per annum on their said accounts, and shall pay the balance to said creditors pro rata, share and share alike in proportion to their several claims, payments to be made quarterly, commencing on the 1st day of March, 1913, and continuing until all of said indebtedness, including principal and interest is paid in full."

In the operation of the plant as shown by the testimony, Mr. MacPhail expended $13,877.74 more than he received and on the date that the Creech

Bros. Lumber Co. became a bankrupt and was adjudged a bankrupt, to-wit, in December, 1914, interest had accrued thereon amounting to the sum of $1292.98, making a total of $15,170.69, for which sum Mr. MacPhail presented his claim to the Trustee in Bankruptcy of the Creech Brothers Lumber Company, and Mr. MacPhail in presenting said claim asked that the same be allowed as a preferred claim. This claim is very full and sets out the facts, is verified under oath and is found on pages 19 to 22 of the Transcript of Record. In this connection we may state that since the claim was verified under oath the allegations thereof must be taken as true unless the same have been refuted by testimony of the petitioner and appellant. The claim among other things contains the following allegations: "And each and all of the creditors entered into an agreement or agreements which are identical in form but for the purpose of convenience were executed in four separate instruments, which were signed by each and all of said creditors, and in said instruments said creditors and each and all of them agreed that any sums advanced or contracted by said H. W. MacPhail in the operation of said plant should be paid prior to the payment of any sums due said creditors." (See page 20, Transcript of Record). All

of the moneys for which Mr. MacPhail presented his claim and which he asked to be made a preferred claim, was paid out by him pursuant to the contracts mentioned with the creditors and stockholders and with the Lumber Company and was paid for the purchase of logs with which to operate the plant and for insurance and taxes on the property of the Creech Brothers Lumber Company. (See pages 36-42, Transcript of Record). Later, and on the 30th day of July, 1914, a Receiver was appointed in the State Courts for the Creech Brothers Lumber Company because it was insolvent, and thereafter and on the 28th day of December, 1914, the United States District Court adjudged the Creech Brothers Lumber Company to be an involuntary bankrupt. When a receiver was appointed by the State Court for said Lumber Company, of course the Receiver took possession of the property, and in that manner Mr. MacPhail was deprived of possession of the property and was unable to reimburse himself by the sale of the property or otherwise as the property was then and is now in the possession of the court.

The Referee in Bankruptcy disallowed priority to the claim of H. W. MacPhail. Thereafter, on an appeal being taken to the United States District

Court, the court allowed the claim in the sum of $13,877.74. For the Findings of Fact and Conclusions of law as made and filed by the Court for Review of the Order of the Referee in Bankruptcy and allowing MacPhail a preferred claim in such sum see Pages 57 to 61 of the Transcript of Record. For the order allowing the claim of Mr. MacPhail as a preferred claim in such sum as made and signed and filed by the Court, see Page 65, Transcript of Record. The order allowing the claim of MacPhail as a preferred claim in said sum is the order from which the petitioner and appellant has appealed. None of the creditors of the Creech Brothers Lumber Company have objected to the allowance of the claim of Mr. MacPhail except A. R. Titlow, as Receiver of the U. S. National Bank of Centralia, and he is the one who is contesting the claim of the respondent and appellee.

Mr. MacPhail took possession of this property about the 1st of November, 1912, and he retained possession thereof until the 30th day of July, 1914, a period of approximately twenty-one months. (Pages 36-47, Transcript of Record). The overhead expense of the plant of the Creech Brothers Lumber Company at the time Mr. MacPhail took possession thereof and while he was in charge was as follows:

Interest on indebtedness which was owing by the Creech Brothers Lumber Co. amounting to about $1000 per month; Taxes, $125 per month; Insurance, $190 per month; Watchman, about the sum of $75 per month; making a total fixed monthly charge of overhead expense against the plant in the sum of $1390 a month, or for twenty-one months the sum of $29,190. (Testimony of B. H. Lewis, Page 43, Transcript of Record).

Mr. MacPhail, while he operated the plant paid to the creditors of the Creech Brothers Lumber Company over $13,000, each creditor receiving ten per cent. on his claim, and in this connection, the U. S. National Bank of Centralia also received a dividend of ten per cent. from Mr. MacPhail while he was operating the plant on its claims, the same claims which are now represented by its receiver, the petitioner and appellant in the case at bar. (Transcript of Record, Pages 40-41-42.).

ARGUMENT, POINTS AND AUTHORITIES,

First.

On October 29th, 1912, when the Creech Brothers Lumber Company entered into the contract with Mr. MacPhail, which contract is found on page 22 of the Transcript, all of the then creditors of the Creech Brothers Lumber Company assented in writing to the execution of that contract and in particular the Willapa Harbor State Bank, consented and at that time the United States National Bank of Centralia was not a creditor but subsequently became a creditor by reason of having purchased certain promissory notes from the Willapa Harbor State Bank which had been executed by the Creech Brothers Lumber Company prior to the execution of this contract.

It will also be borne in mind that Mr. MacPhail operated this plant and was in possession of the same under this contract for a period of some twenty-one months before a receiver was appointed for the Creech Brothers Lumber Company and before Creech Brothers Lumber Company was adjudged a bankrupt.

Mr. MacPhail presented to the Referee and Trustee his claim which was verified, and which

claim is found on pages 19 to 22 of the Transcript of Record. In this claim there is a statement under oath that all of the creditors had assented and consented to the execution of this contract. (See Transcript of Record, page 19). This statement in this claim has never been denied and no testimony was ever introduced disputing or repudiating that statement. The only thing in the record or in the transcript that would tend to refute it is a schedule of creditors whose claims were unsecured, and same was filed by the bankrupt, Creech Brothers Lumber Company, on December 9, 1914, after it was adjudicated a bankrupt, and which was more than two years after the date of the execution of the contract between MacPhail and the Creech Brothers Lumber Company.

The law is that the verified proof of claim is considered as testimony, and if unrebutted, it stands as a proven fact. When the claimant presents his proof of claim, the same constitutes proof, and the same must necessarily be allowed, as it is not the duty of the claimant to prove the allegations of his claim, but it is the duty of the objector to disprove the same.

Collier lays down the rules as follows: "A verified proof of claim will be considered as testimony

in behalf of the claimant; no inference is to be drawn from his failure to testify in his own behalf since he is subject to call by the court or contestant to explain his claim. The verified claim of the claimant has some probative force. It is prima facie of the evidence of allegations contained therein. Persons who object to the claim must produce some evidence in support of the assertion that the claim is invalid." Collier on Bankruptcy, 9th Ed., 738-9. Bauahauer vs. Austin, 26 Am. B. R. 385. 186 Fed. 260. Revg. 24 Am. B. R. 750, 179 Fed. 966.

In the case of Whitney vs. Dresser, 200 U. S. 532-50, Law Ed. 584, the Supreme Court held that the sworn proof of claim against a bankrupt estate is prima facie evidence of the allegations although objection is made under the Bankruptcy Act. The opinion is written by Justice Holmes who says in part: "The Circuit Court of Appeals observes that the proof of claim warrants the payment of dividends in the absence of objection, and therefore, must have some probative force. In reply it is urged that what is done in default of opposition is no test of what is evidence when opposition is made; that a judgment may be entered on a declaration for want of answer, yet a declaration is not evi-

dence; that it is contrary to analogy to give effect to an ex parte affidavit, and that on general principles, it is the right of any party against whom a claim is made to have it proved, not only upon oath, but subject to cross examination. Notwithstanding these forcible considerations, we agree with the circuit court of appeals." "The prevailing opinion not only in the second circuit, but elsewhere, seems to have been that way. The alternative would be that the mere interposition of an objection by any party in interest would require the claimant to produce evidence. For if the formal proof is no evidence a denial of the claim must have the same effect. If it does not, then the formal proof is some evidence, even when there is testimony on the other side."

"The words of the statute suggest, if they do not distinctly import, that the objector is to go forward, and thus that the formal proof is evidence even when put in issue." "It is the objection to the claim which is pointed out for hearing and determination. This indicates that the claim is regarded as having a certain standing already established by the oath. Some force also may be allowed to the word 'proof' as used in the act." Whitney vs. Dresser 200 U. S., 532, 50 Law Ed. 584.

"The presentation of a claim evidenced by promissory notes supported by deposition and proved or duly executed by the treasurer of a corporation, constitute a prima facie cause against the estate and cast the burden upon the objector to go forward with proof."

In the matter of Montgomery, 25 Am. B. R. 432, 185 Fed. 955.

In Re Caster, 15 Am. B. R., 1261, 138 Fed. 846.
In Re Cannon, 14 Am. B. R., 114, 133 Fed. 837.
In Re Summer, 4 Am. B. R., 123, 110 Fed. 224.
In Re Shaw, 109 Fed. 980.

It is incumbent upon the objector to disprove the allegations of the verified claim This the objector, who is petitioner and appellant in this case, has not done. He has introduced no evidence whatever in support of his objections to the proof of the claim, and in his objections he did not raise the question as to whether or not the waivers were signed by all of the creditors.

Second

It is very essential to remember that all of the then creditors of the Creech Brothers Lumber Company entered into a contract in writing with Mr.

MacPhail wherein they agreed that if he would take possession of the properties of the Lumber Company and advance money, and endeavor to operate the same, that all sums of money advanced by him, for the purpose of operating such plant should be a first lien upon the properties of the Creech Bros. Lumber Co., and that he should first pay himself for all moneys so advanced and paid, and pay any surplus, if any there be, over to the creditors in pro rata, share and share alike.

Mr. MacPhail bases his claim upon a contractual obligation, which contract was signed by all of the creditors of the corporation, and by the Willapa Harbor State Bank, which then owned the promissory note which now belongs to the U. S. National Bank of Centralia, and because of this claim Mr. Titlow, as Receiver of the U. S. National Bank of Centralia, is contesting the MacPhail claim.

It must be remembered that when the U. S. National Bank became the purchaser of the promissory notes, that it had full knowledge of all the circumstances and conditions upon which Mr. MacPhail was operating the plant of the Lumber Company. The Willapa Harbor State Bank of Raymond signed the creditors' agreement authorizing Mr. MacPhail to proceed in the manner in which he did. The U. S.

National Bank of Centralia, is successor in interest of the notes due from the Creech Brothers Lumber Company to the Willapa Harbor State Bank.

At the time the Willapa Harbor State Bank sold to the U. S. National Bank these obligations of the Creech Brothers Lumber Company, Mr. C. S. Gilchrist was President of the Willapa Harbor State Bank, and also the Vice President and Manager of the U. S. National Bank of Centralia. The Court will bear in mind that Mr. Gilchrist was one of the moving spirits in getting the creditors to sign this agreement with Mr. MacPhail, so the U. S. National Bank, when it purchased these notes, knew all of the facts and circumstances, and is the successor in interest of this claim of the Willapa Harbor State Bank. Is it possible that the U. S. National Bank, through its Receiver, Titlow, can now be heard to say that it had no notice or knowledge of the rights of MacPhail under these instruments while its own Vice President and Manager, Mr. Gilchrist, who was also the President of the Willapa Harbor State Bank, which signed the agreements, was the moving spirit in bringing about the assignment made by the Creech Brothers Lumber Company? (See Transcript of Record, pages 43-44). If so it may be truly said that a man may stand idly by,

and perpetrate such a fraud upon a man who acts in good faith for the benefit of all and can universally expect the courts to applaud his conduct.

Third-A.

The U. S. National Bank and Receiver thereof are Estopped from questioning MacPhail's Claim, after receiving a dividend on the bank's claim.

We believe that the law is that the United States National Bank, through its receiver, is now estopped to deny Mr. MacPhail's rights under his contract. Where the creditors of an insolvent corporation enter into a contract with an individual, agreeing with him that if he will take possession of the properties of the insolvent corporation, and conduct its business and operate its plants, and advance money for it, and that the moneys so advanced shall be first paid to him, and that he shall have a lien upon the properties of the corporation for all sums of money so advanced or expended by him in the operation, such creditors will not thereafter be permitted to repudiate such a contract, nor to question the priority of the claim of the individual who advanced the money; and they are estopped from questioning the validity or the priority of the claim of the party who, at their

instigation and under a contract with them, expended the funds.

Where the creditors of an insolvent corporation enter into a written contract with another person and agree with him that if he will advance money for the corporation, and conduct its affairs, and that the moneys so advanced by him shall be first paid, and shall be a prior lien upon the properties of the corporation, such creditors and their successor in interest may not repudiate such a contract, nor prevent the party who advanced the money under such a contract from having his claim first paid. They are estopped. Courts will not permit creditors to perpetrate such a fraud upon an individual.

Davis vs. Iowa Fuel Co., 122 N. W. 815, 24 L. R. A. (N. S.) 1166.

The above case has a case note. The case above cited we consider to be parallel to the case at bar. See also:

Gautier vs. Douglas Mfg. Co., 9 N. Y. S. R. 310.

Queen Anne's Ferry & Equipment Co. v. Queen Anne's R. Co., 138 Fed 41, affirmed in 162 Fed. 828.

Bank of California v. Puget Sound Loan, T. & Bkg. Co., 20 Wash. 636, 56 Pac. 395.

American Exchange National Bank of New York

City, vs. Ward, 111 Fed. 782.

McAvoy v. Jennings, 39 Wash. 109.

In the case entitled, Bank of California vs. Puget Sound Loan Trust & Bkg. Co., 20 Wash., 636, the facts and the decision of the Court are well stated in the syllabus of that case, and the syllabus is as follows:

> "Creditors of a bank in the hands of a receiver who consent to the discharge of the receiver and the re-opening of the bank, under an arrangement whereby one of the creditors is to advance money to the bank for the purpose of enabling it to resume business and partially pay outstanding claims, are estopped from claiming they had no notice of a mortgage for an antecedent indebtedness being given in consideration of such advance, when they have agreed to an extension of the time in which the bank might pay their claims, and have received dividends thereon out of the moneys so advanced; and they are also equitably estopped from setting up the insolvency of the bank at the time of the discharge of the receiver, for the purpose of showing that the giving of the said mortgage constituted a fraudulent preference.
>
> "The subsequent insolvency of a corporation cannot be given in evidence for the purpose of affecting the validity of a prior instrument, which was valid at the time of its execution.
>
> "Where general creditors have for more than a year acquiesced in an order of the court discharging a receiver and permitting an alleged insolvent bank to resume business, they

cannot be heard to object that the receiver did not represent them at the hearing."

In the above case the Supreme Court of Washington, on page 642 says:

"Such agreement, as heretofore stated, was presented to the superior court, and that court discharged its receiver, and directed all the property of the bank to be returned to its officers who had been named in the agreement between the creditors and stockholders; and the appellant advanced $7,500 under the agreement to the defendant bank, which, as observed, was used in paying the dividends which were paid to the other consenting creditors, appellant receiving no dividend at any time. The superior court, over the objection of counsel for appellant, admitted much evidence tending to show the insolvency of the defendant bank at the time the order discharging the receiver was made, in November, 1894. We think this was error. In view of the order discharging the receiver theretofore made by the superior court, and the agreement of the creditors which was before the court at that time, the question of the solvency or insolvency of defendant bank became immaterial; and we conclude that the facts shown constitute an equitable estoppel against the consenting creditors, and they may not now set up the insolvency of the defendant bank at the time mentioned in November, 1894, or prior thereto."

The case of Davis v. Iowa Fuel Co. (Iowa, 122 N. W. 815, 24 L. R. A. (N. S.) 1166, is parallel to the

case at bar. The facts of the case as stated by the court are:

"On July 19, 1906, the defendant Iowa Fuel Company was an insolvent corporation. It had been engaged in the retail coal business at Sioux City for some time next preceding such date. On such date it was indebted to various creditors in a total amount of about $4,000, and its total assets had a value of about $2,000. On the date named all the then existing creditors of the corporation entered into an agreement with each other and with such corporation, whereby it was proposed to conduct the business of the corporation in such a way as to enable it in time to pay the creditors involved. It was therefore agreed by all of the parties to this agreement that the business of the Iowa Fuel Company, with all of its property and assets of every kind, be placed in the hands of C. S. Graham, who is agreed upon as a trustee 'to take possession and charge of said business and of the property and assets belonging thereto, and conduct the same for a period of one year from this date.' It was provided in such contract that the trustee should receive $75 per month, that he should execute to the creditors a bond in the sum of $1,000, and that one Fields should be the agent of the creditors 'to supervise the conduct of the business as carried on by said trustee,' and 'to decide the amount of expense which may be incurred by the said trustee in carrying on said business.' It was also provided: "Whenever, in the judgment of said Field, there are sufficient funds on hand over and above the amount necessarily expended for current expenses, the same shall be distributed among the different creditors pro rata.' It was also pro-

vided that all funds should be deposited in the name of 'W. S. Graham, trustee,' and that all disbursements should be made by checks drawn in the same way. From such date the business was conducted by the trustee in pursuance of such contract. As such trustee he purchased coal from the appellees in large quantities, and sold the same in the course of trade. The joint enterprise so undertaken by the creditors did not prove successful, and a receiver was finally appointed for the corporation. The person who was so appointed as receiver was W. F. Tuttle, one of the creditors who had entered into the agreement of July 19, 1906. He converted the assets of the corporation into money. This controversy arose over the final order of distribution. Those creditors whose claims of indebtedness were incurred by Graham, trustee, in the conduct of the business since July 19, 1906, demanded that the assets in the hands of the receiver be first applied to the payment of their claims so incurred by the trustee. The trial court so ordered. The other creditors have appealed from such order."

On the above state of facts the Court in that case said:

"The case is so unique in its facts that no precedents can be cited to aid us. On principle, however, we are well satisfied with the conclusion reached by the trial court. It is urged by the appellants that all creditors should stand on an equality. Their argument is that Graham was the former manager of the Iowa Fuel Company and one of its principal stockholders, and that he conducted the business as before, and that there was, therefore, no substantial change,

and that the new creditors extended credit to the corporation as the former creditors had done. It is argued that the former creditors simply forebore litigation, and that they should not be penalized therefor. But the premise of fact upon which such argument is based is not sustained by the record. The insolvent corporation surrendered its dominion over its property to the creditors, who undertook to manage it more economically and successfully than had previously been done. Their motives were commendable. But the fact remains that they entered into the joint enterprise, and that they put the property and business into the hands of a trustee, who was directly accountable to them, and from whom they required a bond, and to whom they stipulated a compensation. True, they stipulated against personal liability. But they forebore to apply the property to the payment of their claims, and they put it up as a capital for the time being, and sent their trustee into the commercial world to purchase merchandise upon the faith of it. Such purchases of merchandise were absolutely essential to the conduct of the enterprise. No merchandise could have been bought upon the credit of an insolvent corporation except by deception. Surely no fraud or deception was contemplated by the parties. It may be doubted whether the appellees are strictly creditors of the insolvent corporation, in the ordinary sense. Certain it is that they are creditors of the trustee, and the trustee was the creation of the appellants. Under the facts appearing here, the elementary principles of equity require that the claims of the appellants be postponed to those which were made in their behalf by their trustee."

We believe that the case of the American Exchange National Bank of New York City vs. Ward, 111 Fed. Rep. 782, (C. C. A.) is parallel and quite similar to the case at bar. In that case the facts are fairly well stated in the syllabus, which is as follows:

> "A mercantile corporation had four unsecured creditors, three of whom, holding much the larger part of its indebtedness, as well as all of its preferred stock, by agreement with the common stockholders obtained the election of their representatives as directors and manager; the purpose being to secure a change of management because the business of the company had become unprofitable. The fourth creditor was advised of such action, and made no objection. Such creditors remained in control for 2 1-2 years, during which time they paid the fourth creditor one-third of its claim, but increased the indebtedness of the corporation to themselves by advancing money for its use. It did not appear that any new outside indebtedness was created. At the end of that time, the business having remained unprofitable without the fault of the management, the directors had a chattel mortgage and trust deed executed conveying the property of the corporation to secure its creditors; preference being given to the claims of the controlling creditors. There was no evidence of fraud or bad faith, but, on the contrary, the evidence justified the inference that their action in assuming control was for the purpose of benefitting the corporation and all of its creditors. Held, that there was neither actual nor constructive fraud in the transaction which

rendered the preference voidable by the fourth creditor, who was not injured, but was in fact the only one of the four benefitted, by the transaction."

McAvoy v. Jennings, 39 Wash. 109, was a case where a co-partnership entered into a contract with one Jennings, and the agreement substantially provided that, whereas, the co-partnership business had become indebted to various persons and firms, and in order to endeavor to pay the claims which the co-partnership business owed, all of the property of the co-partnership was transferred to Jennings, with authority by Jennings to sell the property and collect the accounts, and after deducting the expenses of administering the trust, to apply the proceeds arising from said sale and collections ratably to the claims of all creditors mentioned. Immediately after the execution of the agreement Jennings took possession of the property mentioned, and afterwards sold the tangible property and proceeded with the collection of the book accounts of the co-partnership. The American Savings Bank & Trust Company was one of the creditors, and after the transfer to Jennings had been made, the bank assigned its claim to McAvoy, who thereupon commenced an action in the Superior Court of King County to reduce the

claim to judgment against the members of the co-partnership, and in that action McAvoy caused Jennings to be summoned as a garnishee defendant.

In that action Jennings appeared in the garnishment proceeding and answered, denying that he was indebted to said co-partnership or any member thereof, and denying that he had any property in his possession or under his control belonging to the defendants in the action; and by way of further answer alleged the trustee agreement above mentioned; and alleged that he had taken possession of all the property therein stated, and had converted the same into money, and that this money he was prepared to distribute pro rata among the creditors in accordance with the said agreement.

The plaintiff filed a reply denying the allegations in the answer, and alleged that the agreement and transfer of the property to Jennings was fraudulent and void as to the creditors.

The Court in passing upon the case said:

> "Conceding, for the purpose of this appeal, that the transfer is void as to the creditors not parties thereto, without intending to decide that question the judgment of the lower court should be reversed."

The Court said: "It is clear that if the

transfer of the co-partnership property was made to the appellant by the co-partnership, at the instigation of the creditors, for the purpose named, the transfer was not void as between the parties. A creditor, who was a party to the transfer and at whose instance and for whose benefit the transfer was made, cannot be permitted to say that it was fraudulent as to him, or that, because it was fraudulent as to some other creditors, he may take advantage of his own wrong and thereby obtain a preference by attachment or garnishment."

The above case is very parallel to the case at bar and sustains the principle that the claim of MacPhail is a prior claim.

In the Memphis Savings Bank vs. Houchens, 115 Fed. 96, the principles involved are much the same as the principles involved in the case at bar, and the Court said:

"The case in hand is similar, in most respects, to one recently decided by the supreme court of Arkansas. Martin v. Taylor, 52 Ark. 389, 400, 12 S. W. 1011. In that case it appeared that, after a firm had become insolvent and certain attachments had been levied on its property, the creditors of the firm entered into an agreement among themselves and with the members of the firm, whereby all of the firm property was conveyed to certain assignees, who were vested with the power to sell and dispose of the same and distribute the proceeds among the creditors of the firm, preferences being allowed in favor of certain attaching creditors. Sub-

sequently one of the attaching creditors became discontented, and erased his name from the agreement, and then sought to ignore it, and enforce his attachment lien, on the ground that under the laws of Arkansas the agreement amounted to a general assignment for the benefit of creditors, and was void on its face. It was held, however, that the persons who thus attempted to assail the agreement, being parties thereto, and having assented to it, were estopped from challenging its validity. In the case of Paxson v. Brown, 27 U. S. App. 49, 59, 10 C. C. A. 135, 142, 61 Fed. 874, 880, this court applied the same doctrine, holding, in substance, that after creditors had become parties to a voluntary assignment, executed outside of the State of Arkansas, which was good at common law, and had accepted dividends thereunder, which had been paid by the assignee, they could not repudiate the assignment on the ground that the assignment was inoperative, and that acts done thereunder were void, because the assignee had not filed a bond and inventory, as the laws of Arkansas required. It is held very generally, and the authorities on this point may be said to be uniform, that creditors who have confirmed an assignment, which might have been avoided, by receiving benefits under it, or who have voluntarily become parties to it with full knowledge of all the facts attending its execution, are afterwards estopped from impeaching it. They cannot play fast and loose, but must make their election to repudiate it before they have accepted any benefits thereunder or by their acts have become parties to it.

Adlum v. Yard, 1 Rawle, 163, 171, 18 Am. Dec. 608;

Valentine v. Decker, 43 Mo. 583;

Rapalee v. Stewart, 27 N. Y. 311;

Glass Co. v. Baldwin, 27 Mo. App. 44;

Harrison v. Mock, 10 Ala. 185;

Stoller v. Coates, 88 Mo. 514, 521, 522, 523;

Burrill, Assignm. (6th Ed.) Sec. 454.

"This doctrine, without doubt, is applicable to the case in hand and, even if it be conceded that the appellants might have attached the lands in controversy after the execution of the deed of assignment, yet it is clear that they cannot be conceded any such right after becoming parties to the composition agreement, and after consenting that the lands conveyed to Trezevant, as trustee, might be held as security for the payment of the composition notes. Such consent, voluntarily given, estops them from seeking to appropriate the proceeds of those lands exclusively to the payment of their own claims, without reference to the rights of the other creditors."

In Tiffany v. Boatman's Sav. Inst. 18 Wall. (U. S.) 375, 21 L. Ed. 868:

"It is not difficult to see that in a season of pressure the power to raise ready money may be of immense value to a man in embarrassed circumstances. With it he might be saved from bankruptcy, and without it financial ruin would be inevitable. If the struggle to continue his business be an honest one, and not for the fraudulent purpose of diminishing his assets, it is not only not forbidden, but is commendable, for every

one is interested that his business should be preserved. In the nature of things he cannot borrow money without giving security for its repayment, and this security is usually in the shape of collaterals. Neither the terms nor the policy of the Bankrupt Act are violated if these collaterals be taken at the time the debt is incurred. His estate is not impaired or diminished in consequence, as he gets a present equivalent for the securities he pledges for the repayment of the money borrowed. Nor in doing does he prefer one creditor over another, which it is one of the great objects of the Bankrupt Law to prevent. The preference at which this law is directed can only arise in case of an antecedent debt. To secure such a debt would be a fraud on the Act, as it would work an unequal distribution of the bankrupt's property; and therefore, the debtor and creditor are alike prohibited from giving or receiving any security whatever for a debt already incurred, if the creditor had good reason to believe the debtor to be insolvent. But the giving securities when the debt is created is not within the law, and if the transaction be free from fraud in fact, the party who loans the money can retain them until the debt is paid. In the administration of the Bankrupt Law in England this subject has frequently come before the courts, who have uniformly held that advances may be made in good faith to a debtor to carry on his business, no matter what his condition may be, and that the party making these advances can lawfully take securities at the time for their repayment. And the decisions in this country are to the same effect."

Third-B.

The U. S. National Bank and Receiver thereof are Estopped from questioning MacPhail's Claim, after receiving a dividend on the bank's claim.

We do not care what name may be given to the instruments executed by the Creech Brothers Lumber Company and the creditors thereof, surrendering the property of the Lumber Company to MacPhail. We do know that MacPhail took the property under these instruments and went into the possession thereof, and advanced and expended his money in an endeavor to benefit all the creditors. If the instrument be denominated an assignment for the benefit of creditors, even then the creditors who signed the agreement and their successors in interest, and the creditors who received dividends are estopped from questioning MacPhail's rights under those instruments. In the state of Washington, an insolvent corporation may make a common law assignment.

Nyman vs. Barry, 3 Wash. 734.
McKay vs. Elwood, 12 Wash., 579.
Damon vs. Leque, 14 Wash., 249.

In Damon vs. Leque, 14 Wash., 249, the Court says:

> "The fact that we have held that an insolvent corporation in this state cannot make a statutory assignment, avails appellant nothing. Such a corporation may make a common law assignment."

And in Olsen vs. Bank of Tacoma, 15 Wash., 150, the Court said:

> "That an insolvent corporation can make an assignment of all its property, which might well be called a common law assignment, and which will have the effect of transferring to the assignee title to the property, for said proposition has been repeatedly held by this court."

MacPhail's rights rest upon a contractual obligation wherein the corporation and all of the creditors thereof agreed that if he would attempt to operate the business of the Creech Brothers Lumber Company, and endeavor to keep it a going concern for the benefit of the creditors of the corporation, that all sums of money advanced by him for the purpose of operating such plant should be a first lien upon the properties of the Creech Brothers Lumber Company and that he should first pay himself for all moneys so advanced, and pay the surplus if any there be, to be paid, over to the creditors in pro rata, share and share alike. This was a solemn contractual obligation, which the predecessor in interest of

the U. S. National Bank agreed to; and the U. S. National Bank purchased its claim from a creditor who had signed this agreement, and when it purchased, it knew all of the facts and had notice thereof. And the U. S. National Bank received from MacPhail a dividend on its claim.

It will be remembered in this connection that MacPhail paid out his money in order that the policies of insurance on the property would not be cancelled, and that he paid the taxes on the property of the corporation to save it from being sold for delinquent taxes. Has he no rights in the premises? May the creditors enter into such a contract and after he has spent his money for their protection, then repudiate their solemn agreements, and say to him, "You were foolish, and will take nothing. We perpetrated a fraud upon you, but the Courts will not protect you." Such is not the law.

See authorities heretofore cited and also
Paxson vs. Brown, 61 Fed. 874.
Memphis Savings Bank vs. Houchins, 115 Fed. 96.

In 61 Fed. 874, particularly on page 880 and 881, the Court says:

"It was a valid assignment at common law, and it was perfectly competent for the debtors, the assignees, and all the creditors to agree that the property of these debtors should be conveyed to the assignees in trust to be sold at private sale, and that the proceeds thus realized should be applied to the payment of the claims of the creditors, without a compliance with the assignment laws of these states. These laws were enacted for the benefit of the parties to such assignments, but all of these parties might, by agreement, waive the benefit of such laws. Thus the parties to this assignment did. The debtors conveyed the property to the assignees to be sold for the benefit of the creditors. The assignees accepted and executed the trust. The creditors accepted the benefits of it, and received therefrom 20 per cent. of their claims. Can any of these parties, after the execution of this trust, and while they still retain the benefits derived from its execution, repudiate the assignment, and recover back from the purchaser the lands the proceeds of which they enjoyed?"

It will be remembered that in this particular case the Willapa Harbor State Bank, who then owned the claim which the U. S. National Bank now owns, received a dividend of ten per cent from MacPhail, the dividend being profits arising from the operation of the plant. Can such an agreement now be repudiated by the U. S. National Bank? In the above case the court also says:

"No principle is more salutary, none rests

on more solid foundations, than that one who by his acts or representations, or by his silence when he ought to speak out, intentionally or through culpable negligence, induces another to believe certain facts to exist, and the latter rightfully acts on such a belief, so that he will be prejudiced if the former is permitted to deny the existence of such facts, is thereby conclusively estopped to interpose such denial. This principle is salutary, because it represses fraud and falsehood."

In the case of Taylor v. Seriler, 100 Ill. App. 643, affirmed in 65 N. E. 433, it was held that creditors who file a claim with the assignee, and receive dividends from the assigned estate, cannot be permitted to repudiate it, and at the same time enjoy the benefits of the assignments.

In case of Reassignment of Geo. T. Smith M. Purifier Company, 48 N. W. 864, (Mich.) the Court held that the right of a creditor to complain of an assignment for the benefit of creditors in the execution of which there may have been fraud as to creditors, may be secured by waiver or acquiescence; the court taking the view that having come is under the assignments in such a way as to entitle him to a share in the dividends arising from the assets in the hands of the assignee, such creditor waives all objections to his title to such assets.

In Dickerson v. Colgrove, 100 U. S. 578, 25 L. Ed. 618, the Court said:

> "The estoppel here relied upon is known as an equitable estoppel, or estoppel in pais. The law upon the subject is well settled. The vital principle is, that he who, by his language or conduct, leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden. It involves fraud and falsehood, and the law abhors both. This remedy is always so applied as to promote the ends of justice."

In the case of Lanahan vs. Latrobe, 7 Md. 268, the Court held, that the creditor who claims a share in the proceeds of a sale under a deed of trust, makes himself so far a party to such deed as to lose his right to deny its validity.

In Swanson vs. Tarkington, 54 Tenn. 612, the court held, that a party accepting the provision of a deed of trust for his benefit, affirms the instrument in toto and is estopped from impeaching any of its provisions for the benefit of other parties.

In Adlum v. Yard, 1 Rawle, 163, the Court said: "that creditor might originally have repudiated the assignment, but having taken a dividend under it, he should no longer question its validity."

In Rapalee v. Stewart, 27 N. Y. 310, the Court held, that it would be a fraud upon all the other creditors to allow one who had assented to the assignment to repudiate it, and thereby gain a preference and secure his entire debt.

In Chafee v. Fourth National Bank, 71 Maine, 36 Am. Rep. 345, the court said: Personal privileges may undoubtedly be waived, although secured by the positive provisions of a statute; and when a creditor, to whom the law secures the right to avoid an assignment made by his insolvent debtor assents to the assignment, or knowingly avails of the benefits thereby secured to him, we think he thereby waives his right to treat the assignment as void.'

In Bodley v. Robbins, 7 Howard 276, 12 L. Ed. 699, the Supreme Court of the United States held that where a creditor acquiesces in the assignment or receives a benefit or a dividend, that he may not question the transaction.

In Jencks vs. Quidnack Co. 135 U. S. 457, 34 L. Ed. 200, the Supreme Court of the United States held:

"Where a debtor, having large and scattered properties, and being much embarrassed,

transfers his property for the benefit of his creditors equally, equity requires that any creditor who is not satisfied with the provisions of such transfer shall act promptly in challenge thereof, or else be adjudged to have waived any right of challenge."

In that case the court further said:

"We do not feel called upon to decide, as a question of absolute law, whether the conveyance was or was not valid, and beyond challenge. It is for the purpose of this case that it was with the general acquiescence of the creditors; that its purpose was equally between them; that it was not challenged for many years; that the trustee, on the faith of its validity, carried on business to an enormous extent and assumed large liabilities; and **that the creditors accepted payments made out of the proceeds of that business, and the trust created by this conveyance.** Equity will not reach out its hands to disturb that which all parties have considered settled for so many years."

Fourth.

MacPhail has an Equitable Lien By Contract.

The Creech Brothers Lumber Company was not adjudged a bankrupt until about two years after the execution of the contracts by the corporation and by the creditors transferring the property of the Lumber Company to MacPhail. Under the contract MacPhail immediately entered into

possession of the property. It is not necessary to record such instruments, especially where MacPhail took possession of the property, as he did in this case.

It must also be borne in mind that the U. S. National Bank is not a subsequent creditor, nor a purchaser. The claim which it owns was owned by the Willapa Harbor State Bank at the time of the execution of these contracts, and the Willapa Harbor State Bank was one of the creditors who signed the contract; and as we have heretofore shown the U. S. National Bank had notice of these contracts, and knew that MacPhail was in possession of the property thereunder, and received a dividend of ten per cent. on its claim from MacPhail. The fact that the U. S. National Bank is not a "subsequent creditor" is quite material, and neither did it ever obtain any lien upon the property of the Creech Brothers Lumber Company for its claim. The lien in favor of MacPhail created by the contracts is an equitable lien which the courts recognize, and enforce, and especially do the bankruptcy courts enforce such a lien.

> "An equitable lien enforceable against the trustee in bankruptcy may be created by agreement."

1 Loveland on Bankruptcy, Sec. 460, and the authorities there cited.

In re Pittsburg Industrial Iron Works, 179 Fed. 151.

Goodnough Mer. & Stock Co. vs. Galloway, 171 Fed. 940.

Duplan Silk Co. vs. Spencer, 115 Fed. 689.

In re Levin, 173 Fed. 119.

In 179 Fed. 151, Supra, the Court held:

"An equitable lien is created where a bank, to enable the bankrupt to proceed with the manfacture of a car contracted for, advanced the full price of the contract to the bankrupt, giving notice of the advancement to the vendee, who promised to pay the bank, and when the vendee refuses the car, the bank may take and hold it for its lien created beyond the four months' period."

"A transfer of property by an insolvent to a creditor with consent of all his other creditors, is not a preferential sale which can be set aside by the trustee."

1 Loveland on Bankruptcy, Sec. 528.

In re Miller, 1 Br. Rep. 410.

In Judson vs. Courier Company, 8 Fed. Rep. 422, the court said:

"It is plain, moreover, that neither the

words nor policy nor intent of the bankrupt act forbid any settlement by a debtor with his creditors, nor any disposition of his property, to which all his creditors assent. In re Miller, 1 B. R. 410. In providing for the disposition of the bankrupt's estate through trustees, to be chosen by the creditors and subject to the direction of a committee appointed by them, the bankrupt act itself (Section 5103) recognizes the controlling power and interest of even less than the entire body of creditors. An omission of a creditor's name from the schedule of creditors, if made with the creditor's assent, has been held not to be a 'wilful or fraudulent' omission. In re Needham, 2 B. R. 387. A transfer is not, then, a fraud upon the act if made with the consent of all persons in interest fairly obtained, however unequal in its results the transfer may prove. Such a consent is a virtual waiver of all the benefits of the bankrupt act, and, when acted on by the transferee, is an estoppel against subsequent incompatible claims under the act. In re Williams 14 B. R., 132, 136; Johnson v. Rogers, 15 B. R. 1; In re Langley, 1 B. R. 559, 565; In re Schuyler, 2 B. R. 549; In re Kraft, 3 Fed. Rep. 892. For the same reason a grantee cannot be held to 'know' a transfer to be a fraud upon the act if it is assented to by all the creditors known to him, or that upon reasonable inquiry he might and would have ascertained or have had reason to suspect."

The contract was good as between the corporation and MacPhail, and it is equally valid as against every creditor who consented to or joined in the execution of the contract, and those who received a

dividend from MacPhail. Such is the equitable rule, and it is based upon common sense and is just.

In Hurley vs Atchinson & Topeka R. R. Co., 213 W. S. 126, 53 L. Ed. 729, the Supreme Court of the United States held that:

> "Where a railroad to assist a coal company in going on, advances money for coal to be mined, the court construed the arrangement as a pledge of a sufficient amount of coal after it should be mined, as security for payment of advances made. 'Equity looks at the substance and not at the form. That the coal for which this money was advanced was not yet mined, but remained in the ground to be mined and delivered from day to day as required, does not change the transaction into one of an ordinary independent loan on the credit of the coal company or upon express mortgage security. It implies a purpose that the coal as mined should be delivered, and is from an equitable standpoint to be considered as a pledge of the unmined coal to the extent of the advancement. The equitable rights of the parties were not changed by the commencement of bankruptcy proceedings. All obligations of a legal and equitable nature remained undisturbed thereby. If there had been no bankruptcy proceedings, th coal as mined was, according to the understanding of the parties, to be delivered as already paid for, by the advancement."

Where a bank loans money to a bankrupt to buy cattle on his verbal promise to give it a lien on

the proceeds from the sale of those cattle, this creates a lien enforceable in bankruptcy. Gardner v. Planters National Bank (Texas 1909) 118 S. W. 1146. The contract was more than four months before bankruptcy and the payment within four months.

An agreement that the creditor should have a present security upon property sold to be manufactured into lumber constituted an equitable lien which attended the property, the logs, and the lumber manufactured from such logs as "equity looks upon things agreed to be done as actually performed." The creditor's lien attends the funds in the hands of the trustee in bankruptcy, and the attachment of another creditor was rendered void by bankruptcy where no attempt was made to preserve it for the estate. Goodnough Mercantile & Stock Co. v. Galloway, 171 Fed. Rep. 940, 22 Am. B. R. 803.

Fifth

Possession of the property of the Creech Bros. Lumber Co. was taken by MacPhail in Nov. 1912 and possession retained by him until a receiver was appointed, and therefore, it was not required that the contract be recorded.

It must be remembered that Mr. MacPhail immediately after the execution of the contract in Oc-

tober, 1912, took possession of all the properties of the Creech Brothers' Lumber Company and operated the saw mill and plant. This was known to the United States National Bank of Centralia of which the petitioner and appellant is receiver. This gave MacPhail a good title to the property and was notice to all the world of his rights under the contract, or written instrument, although, the instrument under which he claimed was not recorded.

Crooks vs. Jenkins, (Iowa) 100 N. W. 82 104 Am. St. Rep. 326 where the authorities are collected in a note.

> "Actual possession of real estate is constructive notice of the party's rights."

Dennis v. Northern Pacific R. Co., 20 Wash. 320 55 Pac. 210.

> "A purchaser of land with actual knowledge that a portion thereof is in the occupancy of other parties than the grantor, has notice sufficient to put him on inquiry as to the rights of such occupants, and is bound to inquire both as to their tenure and the quantity of land thereunder, although such occupants may be in possession of an uninclosed tract under an unrecorded deed."—Kuhl v. Lightle, 29 Wash. 137, 69 Pac. 630.

Watson v. First National Bank, 82 Wash. 65.

Humphrey v. Yateman 198 W. S. 91, 49 Led. 956.

In the case last cited the Supreme Court of the United States says:

> "Taking possession of mortgaged property under an unrecorded chattel mortgage, does not amount to a preference voidable by the mortgagor's trustee in bankruptcy, although such action was taken within four months of the bankruptcy proceedings, if possession so acquired is good as against the trustee under the state laws."

In Watson v. First National Bank, 82 Wash. 65, the Supreme Court of Washington says:

> "A chattel mortgage not recorded as required by statute (Rem. & Bal Code of Washington, Sec. 3660 (P. C. 349 3) while void as to creditors who have acquired some form of lien upon the mortgaged property, is, valid as between the mortgagor and the mortgagee.."

In Heal v. Evans Creek Coal & Coke Co., 71 Wash. 225, 128 Pac. 211, it was said:

> "Whether properly recorded or not, the mortgage was valid as between the mortgagor and mortgagee, and it is only creditors who have acquired some form of lien upon the mortgaged property that can question the right of the mortgagee to foreclose against such mortgaged property."

Where the mortgage is executed and delivered, and prior to the time of its being recorded, persons

other than the mortgagee become general creditors of the mortgagor, but do not become lien creditors until after the mortgage is filed for record, the right of the mortgagee are superior to those of such general creditors. The mortgage speaks as of the date it is placed of record. In Pacific Coast Biscuit Co. v. Perry 77 Wash. 352, 137 Pac. 483, it was said:

> "The conceded facts in this case show that the Pacific Coast Biscuit Company had no specific lien upon any property of the mortgagor at the time the mortgage was filed for record on September 7, 1911. Up to that time, under many decisions of this court, the mortgage was void as to creditors. But when it was filed for record, and when the mortgagee took possession of the property, as he did in this case, his lien became perfect and superior to the claim of the other creditors having no specific lien. We think there can be no doubt of the correctness of this position under the statute.
>
> "In so far as the case of the Willamette Casket Co. v. Cross Undertaking Co., supra, may be said to hold that an unrecorded mortgage is absolutely void and may not become valid when properly filed, that case must be overruled. Under the conceded facts in this case, we think it is clear that the appellant, by reason of recording his mortgage prior to the judgment of the Pacific Coast Biscuit Company, obtained a first lien upon the property covered by the mortgage; and the sale thereof under his mortgage, being regular, passed title to the appellant and, that Oswald had no further interest in the property."

"**Where the mortgagee takes possession of the property covered by an unrecorded chattel mortgage, the mortgage speaks as of the date when possession was taken.** From that time, the mortgage is valid as to all creditors who have not, prior thereto, acquired a right to the specific property or a lien thereon. First Nat. Bank of Fergus Falls v. Anderson, 24 Minn. 434; First National Bank of Madison v. Damm, 63 Wis. 249, 23 N. W. 497; Martin v. Holloway, 16 Idaho 513, 102 Pac. 3, 25 L. R. A. (N. S.) 110; Gagnon v. Brown, 47 Kan. 83, 27 Pac. 104; Garrison v. Street & Harper Furniture & Carpet Co., 21 Okl. 643, 97 Pac. 978, 129 Am. St. 799; Cameron Hull & Co. v. Marvin, 26 Kan. 612."

In the last case cited, speaking upon this question, it was said:

"And if the mortgagee, whose mortgage is not recorded, and who does not have possession of the property, records his mortgage with the consent of the mortgagor, takes possession of the property with the consent of the mortgagor, his mortgage then has the force and effect of a mortgage executed on the day which it is filed for record, or on which the property is delivered. It is the same then as though a new mortgage had been executed by the parties and recorded. The old mortgage is then given life and force and effect by the joint action of both parties, and hence must be held to be valid from that time on, as against all persons."

"In the present case, the possession was taken under the unrecorded mortgage prior to the time when the appellant recovered its judgment and levied execution thereon. Under the

> authorities above referred to, the rights of the respondent by virtue of the mortgage and the possession taken thereunder were superior to those of the appellant, who became a general creditor prior to the taking of the possession, but did not reduce its claim to judgment until subsequent thereto."

In this case MacPhail entered into the possession of the property and operated the mill plant and retained possession until the corporation was placed into the hands of a receiver and adjudged a bankrupt.

The U. S. National Bank of Centralia received a dividend from MacPhail, profits arising from the operation of the plant. The instrument was not required to be recorded by the laws of the state of Washington, but even if it was required to be recorded, possession of the property obviated the necessity of recording.

Sixth.

Present Consideration.

The contract or instrument in writing between the Creech Brothers Lumber Company—under which MacPhail took possession of the property, whether you construe it as a mortgage, deed of trust or an assignment—was and is valid. Mort-

gages made in good faith and for a present consideration are valid.

Thompson vs. Fairbanks, 196 U. S. 516, 49 L. Ed. 577.

Humphrey v. Tatman, 198 U. S. 91, 49 L. Ed., 956.

Tiffany v. Boatman's Sav. Institute, 18 Wall. 375, 21 L. Ed. 868.

I Loveland on Bankruptcy, Sec. 470.

We wish you to remember that MacPhail was in possession of this property under his contract for a period of about two years before the Creech Bros. Lumber Company was adjudged a bankrupt and before the filing of a petition for such adjudication.

The District Court found from the evidence as follows:

That during the operation of the mill MacPhail paid something like over ten per cent. of the claims of the creditors; paid over $3,000 in insurance; over $2,000 in taxes; and upon the mill being closed down, after having paid for all the logs, amounting to over $93,000, and for labor amounting to over $46,-000, together with other items necessarily disbursed, he found that he had expended $13,877.74 more than he had received.

Finding of Fact No. 6, P. 59, Transcript.

Justice and equity affirm that MacPhail should be allowed as a preferred claim the moneys expended by him on behalf of Creech Brothers Lumber Co. and the creditors thereof. He benefitted the corporation, preserved its properties, and paid the creditors ten per cent of their claims. He kept the property from being sold for delinquent taxes, and never asked for nor received any compensation for his personal services. His contract was valid when made, and it would be unjust and inequitable to permit the receiver of the U. S. National Bank to repudiate the transaction after the lapse of over two years, and after receiving from MacPhail ten per cent of its claims, arising from profits made when MacPhail was operating the saw mill plant under the contract.

We submit that the judgment of the District Court allowing MacPhail a preferred claim for the moneys expended by him, should be affirmed, and that MacPhail recover his costs and disbursements herein.

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